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UNCLAS SECTION 01 OF 03 BRASILIA 001168

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TREASURY FOR OASIA - DAS LEE AND FPARODI
STATE PASS TO FED BOARD OF GOVERNORS FOR ROBITAILLE
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TAGS: EINV ECON PGOV EFIN BR
SUBJECT: BRAZIL MOVING FORWARD WITH PUBLIC-PRIVATE PARTNERSHIPS

REF: A) BRASILIA 521 B) SAO PAULO 262

¶1. (SBU) Summary: The GoB is close to launching an inter-agency review of its first two Public-Private Partnership (PPP) proposals for major infrastructure investments, according to Ministry of Planning Chief Economic Advisor Antonio Alves and special PPP coordinator Mauricio Ribeiro. These projects would be reviewed by the Ministers of Planning and Budget (Paulo Bernardo), Finance (Antonio Palocci) and the President's Chief of Staff (Jose Dirceu), who together comprise the PPP Management Committee. The GoB hopes PPPs will make more attractive otherwise marginally profitable investments in infrastructure through arrangements such as cost sharing, joint investments or operating subsidies. Our interlocutors stated that a decree creating the guarantee fund, which would provide PPP investors a guarantee in case the GoB fails to meet its contractual obligations in a particular project, is close to being issued. Many of the details of PPPs would still have to be negotiated in the individual project contract. Even if all goes well, these first two projects would not go out for bids until, at the earliest, end-2005. To help close the widening public infrastructure deficit, the GoB is seeking substantial involvement by foreign firms and investors in PPP projects. In our view, however, the GoB likely has oversold PPPs as the solution for long-standing infrastructure bottlenecks and its past lack of public investment. Many states and municipalities also plan to sponsor PPP projects based on state and local-level statutes that vary from the federal legislation and from each other. End Summary.

¶2. (U) The GoB has set up a PPP Management Committee (MC), consisting of the Ministers of Planning and Budget (a rough OMB-equivalent), Finance, and the President's Chief of Staff, Alves and Ribeiro told Econoffs in an April 18 meeting. The MC will act based on technical-level assessments from all three ministries. Alves and Ribeiro anticipated that the GoB shortly would issue a decree creating the PPP guarantee fund, consisting primarily of stock in large state-owned companies, such as Petrobras, which have been partially privatized and whose stock trades freely on the Sao Paulo exchange. The guarantee fund will serve as a security for investors if the GoB fails to meet its contractual obligations under a PPP. Alves stated that the GoB does not plan to issue a decree with implementing regulations, but rather will tackle these issues in the individual project contracts.

¶3. (U) The GoB has created a multi-stage process to select and structure PPP projects, the first stage of which is a screening by the technicians working for the MC, according to Alves. Those projects that receive clearance at the technical level would be forwarded to the three MC ministers. If approved by the ministers, projects would then be farmed out to a consulting firm for formal study, in coordination with the relevant regulatory agency or sectoral ministry (e.g. transportation). The former are involved because, in many areas, the regulatory agencies retain the formal authority to grant concessions (PPPs formally are considered a modified form of concession contract). Finally, the consultant's study would be presented to the MC for its final approval, a stage that Alves envisioned as a formality in most cases, since most kinks in projects would be worked out in the study phase. After the MC's final approval, projects would be put out to bid. Alves and Ribeiro were proud of the bidding procedures contemplated in the PPP law, saying that the GoB was working to reform its general procurement rules to incorporate some of the innovations in the PPP legislation.

¶4. (U) Alves anticipated that the technical level MC would meet in May to consider the first two proposed PPP projects. He thought it likely these would be forwarded to the MC for their approval relatively quickly, since the projects in question are long-standing proposals that the technicians know well. But, given the need to hire consultants through a formal bid process and then allocate four to five months for them to study the projects, obtain MC approval and then

prepare formal bid documents, the minimum time frame for the two projects to make it to bid would be eight months. Alves noted that the projects in question, which he characterized as transport-related, would speed through the review process as they already had advanced environmental impact studies. He nevertheless characterized the eight-month-timeframe as "optimistic."

¶5. (U) Alves expected that the Ministries of Planning and Finance would play a more circumscribed role in future projects as the sectoral ministries and regulatory agencies improved their capacity to prepare project proposals. Once the whole review apparatus was up and running, Alves thought that the system would be able to process about two projects every three to four months. The bid specifications contained in the first two projects, he explained, would likely serve as a model for those that followed.

¶6. (U) The Planning Ministry, Ribeiro noted, would like to complete a study of obstacles that foreign construction firms face in doing business in Brazil. They would like to reduce at least some of these barriers in order to increase competition in bidding on these large infrastructure projects, which only a handful of Brazilian firms had the capacity to take on. This would help improve the terms of the PPP projects for the GoB and also address a perceived lack of capacity among the large Brazilian firms to take very many of these projects onto their balance sheets. Alves and Ribeiro emphasized that there were no legal restrictions on foreign firms bidding on PPP projects, and encouraged U.S. companies to seriously consider this market.

¶7. (U) Finally, Alves observed that the latest Budget Directives Law (LDO, in its Portuguese acronym), which lays out the GoB's three-year spending plan, currently in Congress, already envisions PPP counterpart spending. This was a prerequisite for inserting the specific PPP counterpart line items in the annual budget law, which would be approved at end-year.

¶8. (SBU) Several individual states are pursuing their own state-level PPP projects. Sao Paulo, Goias, Minas Gerais, Bahia, Santa Catarina and Espirito Santo, among others, have passed laws governing state-level PPPs. Sao Paulo may well initiate an export-import corridor PPP project before the national level PPP project kick-off (ref B). Sao Paulo Econoff met on March 22 with attorneys Ricardo Sanches and Troy Petit of the Sao Paulo-based law firm Felsberg and Associates to discuss PPPs. They expect to see the export-import corridor kick-off this year. Sao Paulo state also has created a guarantee fund, CPP, in the form of a holding company dedicated to PPP projects. CPP also will play a role in assessing project viability. Sanches noted that federal, state and municipal governments will all sponsor PPP projects, with a mix of different regulatory approaches. He cautioned that many other states were less prepared than Sao Paulo and Minas Gerais to prepare and launch PPP projects. The quality of state and municipal level guarantees also might vary widely. Sanches emphasized the importance of the GoB and the states taking a prudent approach to the first PPP projects, as their success or failure would likely prove a bell-weather for future PPPs.

¶9. (U) PPPs may not be as necessary for some states as others. In a meeting with Rio Econoff, the State Secretary for Economic Development of Espirito Santo (ES) said that despite the fact that ES has approved a PPP law, it is counting on its hospitable and investment friendly business environment and fiscal incentives to attract much needed investment and that PPPs are not its priority right now. ES's belt tightening also means that it can invest in those projects that are truly public in nature, i.e., low return on investment.

¶10. (SBU) Comment. The GoB long has been talking up PPPs as its answer to falling public infrastructure investment and the ongoing problem of infrastructure bottlenecks, which are holding back productivity growth. In moments of candor, however, members of the GoB economic team admit that PPPs likely have been oversold as the answer to this set of problems. And, while the jury obviously is still out on their ultimate effectiveness, PPPs look to be more of a band-aid solution to investment rather than the sort of broader measure -- such as overhaul of the Byzantine tax system or efforts to reduce regulatory uncertainty -- necessary to attract the quantity and quality of investment, both domestic and foreign, that Brazil needs.

¶11. (U) This cable was reflects input from Consulates Sao Paulo and Rio de Janeiro.

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